GOLD STAR ENERGY INC.

1995 Annual Report

REPORT TO SHAREHOLDERS

1995 was a very significant year for Gold Star in many respects. As a result of various activities undertaken through 1995, more particularly described below, Gold Star has been able to create an operating base and a large area of core operations in western Saskatchewan that are expected to now see extensive development and continued exploration for oil and gas reserves. Recently the Company has taken steps to provide a full-time and committed management group whose expertise in finance, exploration and geology will enable the Company to vigorously pursue its goals of accelerated growth and shareholder enhancement.

Year In Review

On December 28, 1994 Gold Star acquired certain petroleum and natural gas assets from TriStar Capital Inc. for a consideration of $422,000.00, which was paid by $257,000.00 cash, the issuance of 175,000 Common Shares at a price of $0.20 per share and by incurring $130,000.00 in bank debt. The TriStar acquisition was approved by Gold Star's shareholders and constituted the major transaction of the Corporation, thus moving Gold Star out of the category of a junior capital pool corporation.

In May, 1995 Gold Star purchased from Viewpoint Resources Ltd. and two other parties various working interests in three gross (0.66 net) producing oil and gas wells located in the Hoosier area of western Saskatchewan, as well as a 1.74% interest in the Hoosier Viking Sand Gas Unit. The $300,000 purchase price was paid by a cash payment of $248,888 and the issue of 511,121 Common Shares at a price of $0.10 per share.

In conjunction with the Viewpoint asset acquisition, Gold Star entered into an exploration joint venture with Viewpoint in the Hoosier area. To December 31, 1995 9 (1.4 net) wells were drilled under the joint venture, of which 7 (1.05 net) were completed as producing oil wells and 2 (0.35 net) were suspended as shut-in gas wells.

Financial

In July Gold Star closed a flow-through share offering of 2,333,340 Common Shares at $0.15 per share for gross proceeds of $350,000. These proceeds were expended under the first phase of the Viewpoint joint venture.

In December, 1995 Gold Star closed a further flow-through offering of 2,785,000 units at $0.20 per unit, for gross proceeds of $557,000. Each unit consisted of one Common Share and one Warrant which entitles the holder to acquire one additional Common Share at a price of $0.30 until December 31, 1996. Subsequent to year end, Gold Star expended approximately $445,000 (80%) of these flow-through proceeds under the Viewpoint joint venture.

During the year revenues grew from $3,401 at the end of 1994 to a 1995 year end of $214,974. After deduction for royalties and operating expenses, 1995 net revenue was $109,619 or $0.01 cents per share, based upon a weighted average of 8,214,700 outstanding Common Shares. A net loss of $101,949 was incurred primarily as a result of a $50,000 write-

down resulting from a reduced carrying value of the assets initially acquired by the Company in conjunction with its major transaction as a junior capital pool corporation. On a positive note, Gold Star exited 1995 with daily production of approximately 150 BOPD and excellent prospects for substantial growth for 1996.

Operations

In 1995 Gold Star began to evolve as a competitive junior oil and gas company. By focusing its capital resources and utilizing the expertise of its directors and joint venture partners the Company has been able to establish a core region in western Saskatchewan. From June, 1995 to year end the Company participated in drilling 9 (1.4 net) wells resulting in 7 (1.05 net) oil wells and 2 (0.35 net) suspended gas wells. More importantly, and as a further result of its winter drilling program, Gold Star established development and exploration oil projects at Hoosier/Milton, North Hoosier, Prairiedale, Smiley and Court, Saskatchewan. In each of these areas initial drilling successes and the completion of five three-dimensional seismic programs will result in an aggressive drilling program during the remainder of 1996. This acceleration of the program has now been facilitated by the recent announcement of a new joint venture program with Cabos Resources Inc. and a full-time management team with proven expertise in our core region of western Saskatchewan.

In March, 1996 the Viewpoint joint venture was terminated, and in May, 1996 Gold Star announced the Cabos joint venture to facilitate continued exploration and development of its prospects.

Corporate

In May, 1995 Dieter Gracher agreed to resign from the Board of the Corporation, and sold his shares in the Corporation to Viewpoint, at which time Rick Braund, the principal of Viewpoint, and Daniel Brown joined the Board.

Subsequent to year end, Glenn Huber and Brian Clark have agreed to resign from the Board and sell their shares to a group of investors, including Rick Braund and Harley Winger, two directors of the Corporation.

Messrs. Huber, Clark and Gracher are thanked for their contribution in founding the Corporation.

Recent Events

On May 6, 1996 Gold Star announced the formation of a joint venture agreement with Cabos Resources Inc. The Viewpoint Joint Venture was terminated in March, 1996. Cabos is a private company owned and operated by Messrs. Jack Lee, Duane Domier and Barry Dorin. Mr. Lee was most recently the Chairman and Chief Executive Officer, and Mr. Domier the President and Chief Executive Officer, of Independent Energy Inc., a public oil and gas company that was recently acquired by Stampeder Exploration Ltd. Mr. Dorin also has extensive

experience in operating public oil and gas companies. Messrs. Lee, Domier and Dorin will assume the day to day management of Gold Star effective June 1, 1996 and have agreed to stand for election to Gold Star's Board of Directors at the annual meeting to be held on June 20, 1996. These gentlemen are welcomed to Gold Star, and we look forward to their management and guidance as Gold Star develops into a significant junior oil and gas company.

Finally, we thank the shareholders of Gold Star for their patience and continued support during our first full year of operations. We believe that shareholders will be rewarded for their patience and support as a result of the initiatives taken during 1995 and the newly announced joint venture and management arrangements with Cabos.

May 15, 1995 (signed) Rick F. Braund
on behalf of the Board of Directors

KPMG

KPMG Peat Marwick Thorne
Chartered Accountants

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AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the balance sheets of Gold Star Energy Inc. as at December 31, 1995 and 1994 and the statements of operations and deficit and changes in financial position for the year ended December 31, 1995 and the 233 day period ended December 31, 1994. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the company as at December 31, 1995 and 1994 and the results of its operations and changes in financial position for the year ended December 31, 1995 and the 233 day period ended 1994 in accordance with generally accepted accounting principles.

KPMG Peat Marwick Thorne

Chartered Accountants

Calgary, Canada
May 7, 1996

GOLD STAR ENERGY INC.
Balance Sheet

December 31, 1995 and 1994

		1995		1994
Assets				
Current assets:				
Cash	$	580,114	$	160,170
Accounts receivable		182,690		9,970
		762,804		170,140
Petroleum and natural gas properties (note 3)		951,696		423,047
	$	1,714,500	$	593,187
Liabilities and Shareholders' Equity				
Current liabilities:				
Accounts payable and accrued liabilities	$	366,798	$	6,977
Current portion of long-term debt (note 4)		96,000		58,000
		462,798		64,977
Long-term debt (note 4)		122,000		72,000
Provision for future abandonment and site restoration		4,000		–
Shareholders' equity:				
Share capital (note 5)		1,233,524		462,083
Deficit		(107,822)		(5,873)
		1,125,702		456,210
	$	1,714,500	$	593,187

See accompanying notes to financial statements.

Approved by the Board:

D. C. Brown

Daniel C. Brown

Harley L. Winger

GOLD STAR ENERGY INC.

Statement of Operations and Deficit

Year ended December 31, 1995 and the 233 day period ended December 31, 1994

	1995	1994
Revenue:		
Oil and gas sales, net of royalties	$ 208,050	$ –
Interest income	6,924	3,401
	214,974	3,401
Expenses:		
Operating	98,431	–
Depletion and depreciation	139,000	–
General and administrative	64,416	9,274
Interest on long-term debt	15,076	–
	316,923	9,274
Net loss	101,949	5,873
Deficit, beginning of period	5,873	–
Deficit, end of period	$ 107,822	$ 5,873
Loss per share	$ 0.01	$ 0.00

See accompanying notes to financial statements.

GOLD STAR ENERGY INC.

Statement of Changes in Financial Position

Year ended December 31, 1995 and the 233 day period ended December 31, 1994

	1995	1994
Cash provided by (used in):		
Operations:		
Net loss	$ (101,949)	$ (5,873)
Items not involving cash:		
Depletion and depreciation	139,000	–
Net change in non-cash working capital	187,101	(2,993)
	224,152	(8,866)
Financing:		
Issue of common shares for cash	907,000	500,000
Long-term debt	150,000	130,000
Issue of common shares for petroleum and natural gas properties	51,112	35,000
Share issue costs	(22,171)	(72,917)
Repayment of long-term debt	(62,000)	–
	1,023,941	592,083
Investment:		
Petroleum and natural gas properties	(828,149)	(423,047)
Increase in cash	419,944	160,170
Cash, beginning of year	160,170	–
Cash, end of period	$ 580,114	$ 160,170

See accompanying notes to financial statements.

1. Significant accounting policies:

(a) Incorporation and nature of business:

The Corporation was incorporated under the Business Corporations Act (Alberta) on May 12, 1994 and is classified as a Junior Capital Pool Corporation as defined in Alberta Securities Commission Policy 4.11.

The articles of the Corporation were amended by a Certificate of Amendment issued on August 16, 1994 to remove the private company provisions and the restrictions on share transfer.

The Corporation is active in the acquisition, exploration and development of oil and natural gas properties.

(b) Petroleum and natural gas properties:

The Corporation follows the full cost method of accounting for petroleum and natural gas properties whereby all costs relating to the acquisition, exploration and development of oil and gas reserves are capitalized. Such costs are accumulated in a single cost centre representing the Corporation's activity undertaken exclusively in Canada. These capitalized costs together with production and related equipment are depleted and depreciated using the unit-of-production method based on estimated gross proven petroleum and natural gas reserves as determined by an independent reservoir engineers.

In applying the full cost method of accounting, capitalized costs less accumulated depletion are restricted from exceeding a net recoverable amount equal to the estimated undiscounted future net revenues, based on current prices and costs, derived from proven reserves, less the aggregate estimated future site restoration and reclamation costs, development, general and administrative, financing and income tax costs plus the lower of cost and estimated fair value of unproven properties.

The unit-of-production method is used to provide for estimated future site restoration costs of producing properties and facilities.

Substantially all exploration and production activities are conducted jointly with others and, accordingly, the accounts reflect only the Corporation's proportionate interest in such activities.

(c) Per share data:

Loss per share is calculated using the weighted average number of common shares outstanding during the year. Fully diluted loss per share is not presented as the exercise of share options and the warrants is not dilutive.

1. Significant accounting policies (continued):

(d) Flow-through shares:

The deductions for income tax purposes of expenditures related to exploration and development activities funded by flow-through share arrangements are renounced to shareholders in accordance with income tax legislation. Oil and gas properties and share capital are reduced by the estimated value of the renounced tax deductions when the expenditures are incurred.

(e) Measurement uncertainty:

The amounts recorded for depletion, depreciation and site restoration costs are based on estimates. The cost ceiling test calculation is based on estimates of proved reserves, production rates, oil and natural gas prices and future costs. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

2. Acquisition:

On December 28, 1994, the Corporation acquired the assets of a private oil and gas company for consideration of $422,000 consisting of: $257,000 cash, 175,000 common shares at $.20 per share and the assumption of $130,000 of bank debt. The acquisition has been accounted for as a purchase. The allocation of the purchase price is as follows:

Petroleum and natural gas properties	$ 308,667
Well equipment	113,333
	$ 422,000

3. Petroleum and natural gas properties:

1995	Cost	Accumulated depletion and depreciation	Net book value
Petroleum and natural gas	$ 775,225	$ 111,500	$ 663,725
Well equipment	311,471	23,500	287,971
	$ 1,086,696	$ 135,000	$ 951,696

3. Petroleum and natural gas properties (continued):

1994	Cost	Accumulated depletion and depreciation	Net book value
Petroleum and natural gas	$ 309,714	$ –	$ 309,714
Well equipment	113,333	–	113,333
	$ 423,047	$ –	$ 423,047

As a result of a ceiling test calculation, which was performed with an effective date of December 31, 1995, it was determined that the net book value of the Company's petroleum and natural gas properties exceeded the net recoverable amount calculated under the full cost accounting guideline and a write-down of $50,000 was recorded as additional depletion. The prices used in the ceiling test calculation of December 31, 1995 were $16.20/bbl of crude oil and $1.58/mcf of natural gas which was the 1995 average heavy oil wellhead price. However, had the Company used the year end heavy oil price of $14.79/bbl an additional write-down of $100,000 would have resulted. The ceiling test is a cost recovery test and is not intended to result in an estimate of fair market value.

Oil and gas properties with a net book value of $170,845 have no cost base for income tax purposes. This results from the renunciation of income tax deductions to flow-through share investors.

4. Long-term debt:

	1995	1994
Bank loans bear interest at prime plus 1.00% and are secured by a promissory note in the amount of the loan, a $1,000,000 debenture and a supplemental debenture in the same amount with fixed charges over the Company's interest in certain petroleum and natural gas properties and a floating charge over all other assets	$ 218,000	$ 130,000
Less current portion	96,000	58,000
	$ 122,000	$ 72,000

Subsequent to year end, the Company entered into a loan agreement with another chartered bank. The total bank debt available is $425,000 payable in monthly payments of $25,000 commencing August, 1996 until December, 1997. The new loan bears interest at prime plus 1.5% and is secured by a general assignment of book debts and a $1,000,000 first fixed and floating charge debenture over all assets.

Proceeds from new bank loans repaid the above debt and financed a portion of the acquisition described in note 8.

5. Share capital:

(a) Authorized:

Unlimited number of common shares, without nominal or par value

Unlimited number of preferred shares, without nominal or par value

(b) Issued:

	Number of Common Shares	Amount
Common shares:		
Issued for cash	6,500,000	$ 500,000
Issued for petroleum and natural gas properties	175,000	35,000
Less: share issuance costs	–	(72,917)
Balance, December 31, 1994	6,675,000	462,083
Issued for cash:		
Pursuant to private placement of flow-through shares	5,118,340	907,000
Issued for petroleum and natural gas properties	511,121	51,112
Less: share issuance costs	–	(22,171)
Tax effect of flow-through share funds expended	–	(164,500)
Balance, December 31, 1995	12,304,461	$ 1,233,524

(c) Pursuant to the stock option plan for its directors and officers, the Company has granted options to purchase 650,000 common shares at a price of $0.10 per share, expiring, September 1, 1999 to certain directors of the Corporation.

A single non-transferable option was granted to purchase 350,000 common shares of the Corporation at $0.10 per common share expiring June 8, 1996. No options have been exercised as at December 31, 1995.

(d) In 1995, the Company completed two flow-through share issues. Pursuant to a July 31, 1995 private placement, the Company issued 2,333,340 flow-through common shares at $.15 per share. Pursuant to a December 29, 1995 private placement, the Company issued 2,785,000 flow-through share units at $.20 per unit. Each flow through share unit consists of one flow-through common share and one warrant. The warrant entitles the holder to purchase one common share a price of $.30 per share on or before December 31, 1996. Shares are held in escrow for a period of one year. The Company made qualified expenditures in the amount of $353,365 in 1995. The Company is committed to incur qualified expenditures for the remaining $553,635 before December 31, 1996.

6. Related party transactions:

(a) During the year, the Company acquired oil and gas properties from a Company controlled by a director of the Company for consideration of $300,000 consisting of 511,121 common shares at $.10 per share and cash of $248,888.

(b) Accounts receivable include $179,458 owing from a company controlled by a director of the Company.

(c) Accounts payable include $232,434 owing to a company controlled by a director of the Company.

(d) During 1994, the Corporation acquired oil and gas properties at fair value from a company owned by the former president (note 3). Total consideration paid was $422,000.

7. Income taxes:

The income tax expense differs from the amounts which would be obtained by applying the expected Canadian income tax rate as follows:

	1995	1994
Income tax rate	44.6%	44.3%
Computed income tax recovery	$ (23,100)	$ (2,600)
Non-deductible depletion	6,700	–
Crown royalties	6,450	–
Other	650	–
Alberta Royalty Tax Credit	(4,400)	–
Resource allowance	(6,300)	–
Losses the benefit of which has not been recognized	20,000	2,600
Provision for taxes	$ –	$ –

8. Subsequent event:

Subsequent to year end the company purchased all of the issued and outstanding shares of two private oil and gas companies. The acquisitions will be accounted for by the purchase method. Total consideration for the purchases was $540,000 consisting of $216,000 in cash and $324,000 of subordinated convertible debentures, with an interest rate of 9% payable quarterly, a term of three years, convertible at $.25/share and with a non-call period of 1.5 years. The assets acquired consisted of petroleum and natural gas properties.

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